UNITED STATES DEPARTMENT OF AGRICULTURE
FARM CREDIT ADMINISTRATION
WASHINGTON, D. C.

SUMMARY OF CASES

RELATING TO

FARMERS' COOPERATIVE ASSOCIATIONS

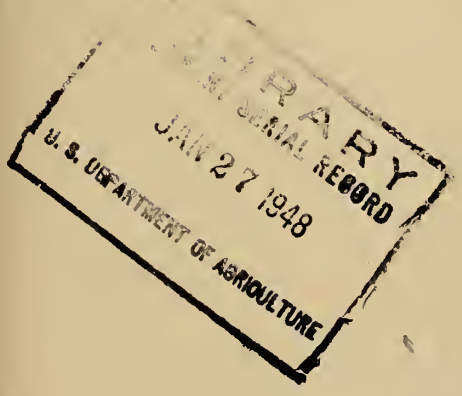
*

* *

Prepared by

Lyman S. Hulbert

Attorney
Office of the Solicitor
Washington, D. C.



For the

COOPERATIVE RESEARCH AND SERVICE DIVISION

Summary No. 36 December 1947

TABLE OF CONTENTS

Mandatory Obligation -- Patronage Refunds Deductible

In the case of Peoples Gin Company, Inc. v. Commissioner, 41 B.T.A. 343, the Board of Tax Appeals (now The Tax Court of the United States) upheld the Commissioner of Internal Revenue and ruled that amounts that had been paid as patronage refunds to stockholders of the Gin Company could not be deducted or excluded in computing the income taxes of this non-exempt cooperative because the bylaw providing for the making of such refunds was not adopted until after the money in question had been received by the cooperative. The case was then appealed by the Gin Company to the Circuit Court of Appeals for the Fifth Circuit (Peoples Gin Company, Inc. v. Commissioner of Internal Revenue, 118 F.2d 72) and that court affirmed the ruling of the Board of Tax Appeals. In doing so the court said in part:

"The petitioner contends here as it did before the Board that the payment of $3,684.70 to its stockholders was a 'patronage dividend', a rebate or refund of excess ginning charges, and that this sum should have been allowed as a proper deduction from its gross income. In support of this contention it relies upon Treasury Ruling A.R.R. 6976, Cumulative Bulletin June, 1924, P. 287; Uniform Printing & Supply Co. v. Commissioner, 7 Cir., 88 F.2d 75, 109 A.L.R. 966; Fruit Growers' Supply Co. v. Commissioner, 9 Cir., 56 F.2d 90; Riverdale Co-op. Creamery Co. v. Commissioner, 9 Cir., 48 F.2d 711.

"This case is different from the cases relied upon by the petitioner. In those cases where the deduction was allowed the obligation to make rebates or refunds was in existence before the profits were earned.

"The resolution of August 9, 1933, relative to ten per cent dividend payments did not bind the gin company to make rebates or refunds to stockholders on a baleage basis. Until the adoption of the resolution of December 8, 1933, there was nothing in the corporation by-laws providing for a refund of excess charges to stockholder patrons. The distribution to stockholders which was made on January 15, 1934, was pursuant to the by-laws of December, 1933, which by-laws had been adopted subsequent to the earnings of the profits by the ginnery. When this income was received by the corporation there was no obligation to make refunds or rebates to stockholders. The profits from ginnings for stockholders, therefore, became a part of the gross income of the taxpayer, and the character of this income for tax purposes was not changed by the adoption of subsequent resolutions and by-laws. Cf. Fruit Growers Supply Co. v. Commissioner, 9 Cir., 56 F.2d 90; Brown v. Helvering, 291 U.S. 193, 199, 54 S.Ct. 356, 78 L.Ed. 725; North American Oil Co. v. Burnet, 286 U.S. 417, 424, 52 S.Ct. 613, 76 L.Ed. 1197.

"The facts of this case make it clear that the distribution to stockholders was nothing more than a dividend paid out of profits

of the corporation. Cleveland Shopping News Co. v. Routzahn, 6 Cir., 89 F.2d 902; Lincoln Nat. Bank v. Burnet, 61 App.D.C. 54, 63 F.2d 131; Hudson v. Commissioner, 6 Cir., 99 F.2d 630.

"The Board properly held that the distributed sum of $3,684.70 should be included in the gross income of the petitioner." (Emphasis added.)

The income taxes that were involved in the foregoing case were those in connection with the business of the Gin Company in the year 1933.

Apparently in an effort to amend its organization papers so as to obligate itself to make patronage refunds in tax years following 1933, the stockholders of the Gin Company, at a meeting held on May 5, 1934, unanimously adopted the following resolution:

"Whereas all the stockholders have spent considerable time and money in organizing, the soliciting and securing customers for the gin, And further, it is seen that the profit from the outside ginning (cotton ginned by [for] non-stockholders) will take care of all payments of notes, and other obligations. It is therefore resolved that the by-laws on page seven (7) be changed to read: Each year, after the close of the ginning season, before the net profits of the gin are declared that each and every stockholder be reimbursed any amount that he has paid into the gin in excess of actual cost of ginning his cotton. In other words that all stockholders cotton be ginned at actual cost."

In addition, the Gin Company for all years subsequent to 1933 entered into an agreement with each of its stockholders, identical, except that in each case the name of the stockholder was different, with the following:

"Lambert, Mississippi, August first, 1934

"The Peoples Gin Company, Inc. agrees to pay to H. E. Anderson the full sale value for all seed ginned and left at this gin by him, less the necessary handling and selling expenses and to gin his cotton at cost, and final settlements to be made at the end of the ginning season when all expenses and profits have been determined, and this agreement shall continue from year to year, and until cancelled by either party.

"ACCEPTED:
E. H. Anderson

PEOPLES GIN COMPANY INC.
By C. W. McCullar,
President."

The Commissioner of Internal Revenue ruled that the Gin Company had filed tax returns covering income and excess profits taxes for the years 1935 to 1940, inclusive, which were deficient, and the Gin Company then carried the case to The Tax Court of the United States. In the unreported opinion of that court (Docket Nos. 111436, 452) the court said:

"The principal question for determination is whether amounts returned by petitioner to its stockholder patrons pursuant to written agreements with them, which amounts represented the excess over the cost of ginning their cotton and selling their cotton seed, were deductible from petitioner's gross income as part of the cost of goods sold."

In holding that the amounts in question were deductible, the Tax Court said in part:

"Petitioner claims that by virtue of its by-laws, and under the written agreements with its stockholders, it was legally obligated to make such payments, and, as a result, the payments are deductible from gross income. Petitioner contends, further, that these payments constituted a rebate or refund of the excess of the amount paid by each stockholder patron over cost and never at any time belonged to or became the profits of petitioner.

"In support of this contention, petitioner relies particularly on Uniform Printing & Supply Co. v. Commissioner, 88 Fed. (2d) 75; and cites among others, Trego County Cooperative Association, 6 B.T.A. 1275; Home Builders Shipping Association, 8 B.T.A. 903; Anamosa Farmers Creamery Co., 13 B.T.A. 907; Farmers' Union State Exchange, 30 B.T.A. 1051; and Anderson-Clayton Securities Corporation, 35 B.T.A. 795.

"Respondent contends that the amounts so distributed constituted a part of the corporate profits so that the distributions were dividends and no deduction is allowable in determinging petitioner's net income.

"Respondent's contention cannot be sustained. The facts of this case bring it within the rule established by Home Buildings Shipping Association, supra, and Uniform Printing & Supply Co. v. Commissioner, supra. There was a definite liability on the part of petitioner to pay its stockholder patrons the excess over the cost of ginning their cotton and selling their cotton seed. Payments of rebates or patronage dividends to stockholder patrons on the basis of their patronage are allowable where there is a definite liability to make such payments. Farmers Union State Exchange, supra. The fact that petitioner was organized under the provisions of Mississippi law dealing with the organization of general business corporations is not controlling. Home Builders Shipping Association, supra; Uniform Printing & Supply Co., supra.

"Petitioner was organized by a group of cotton farmers for the purpose of operating cooperatively in having their cotton ginned and their seed sold at cost. All its stockholders were cotton farmers. Under the by-laws, the stock could be sold only to persons actually engaged in the production of cotton. The patronage distributions were determined upon the number of bales ginned for each stockholder in proportion to the total number of bales ginned during the year.

"The ginning business in Lambert, Mississippi, was highly competitive. There were three gins in the town and not enough cotton to be ginned to keep them all busy. As a result, it was customary for each gin to give substantial rebates to its customers. Petitioner's stockholders could have secured these benefits if they transferred their business to the other gins. It was for this reason that petitioner entered into the written agreements with its stockholders that the excess of the cost of ginning the cotton and selling the cotton seed should be returned to them. The agreements were not executed with the stockholders solely because they were stockholders as was the case in Fontana Power Co., 43 B.T.A. 1090; affd., 127 Fed. (2d) 193, relied upon by respondent. Here, petitioner paid rebates to non-stockholder patrons which respondent in brief admits are deductible by petitioner as part of the cost of goods sold. Under the facts of the case we cannot see why a different rule should be applied to stockholder patrons.

"The same conclusion was reached under somewhat similar facts in Uniform Printing & Supply Co., supra., where it was said at page 76:

> Had the taxpayer given a customer (whether stockholder or outsider) a discount promptly after filling the order, no one would call it a dividend. If a rebate were given promptly upon the customer's business reaching a certain volume, the same conclusion as to its character would follow. To make cost estimates and adjust them at or near the end of each year returning the excess payment to the customer should not change the reasoning which leads to this conclusion. Nor should the fact that the customer is a stockholder materially affect the result.

"The Supreme Court of Mississippi followed the same rule in the case of State et al. v. Morgan Gin Co., 189 So. 817, where it held that amounts refunded by the taxpayer to its stockholder patrons pursuant to agreements with them and based upon the volume of business contributed by them were not income to the taxpayer.

"Respondent relies on a decision in a former proceeding brought by petitioner entitled Peoples Gin Co., 41 B.T.A. 343; affd., 118 Fed. (2d) 72. However, in that case which involved the year ended July 31, 1934, the contracts and by-laws referred to here were not in effect prior to the ginning season and prior to the earning of petitioner's income. The Circuit Court of Appeals in its opinion said: * * *"

The Tax Court then referred to the holding of the Circuit Court of Appeals and quoted several paragraphs therefrom, which quotations appear in the early part of this article. It concluded its discussion of that opinion by saying:

"It is apparent that the crux of this decision was that at the time the income was earned there was no legal obligation on the part of petitioner to make the rebates or refunds to its stockholder patrons. The situation here is entirely different in that not only by-laws but written agreements were in effect prior to the earning of the income here involved, which obligated petitioner to make the refunds.

"Respondent also relies on Juneau Dairies, Inc., 44 B.T.A. 759. That case, however, is distinguishable since the taxpayer was required to pay to its stockholders a bonus of its entire net profit which included income from a non-stockholder patron. In this case petitioner paid tax on the income derived from its non-stockholder patrons, and the profits from this source became corporate profits distributed as dividends on the capital stock.

"Considering all the facts, it is held that the payments in question were made as refunds rather than as dividends to stockholder patrons. Petitioner is therefore entitled to deduct these refunds from its gross income in each of the taxable years here involved." (Emphasis added.)

The Tax Court further held that any claim against the Gin Company for additional taxes by the Commissioner of Internal Revenue for the year 1938 was barred by subsection (a) of the Revenue Act of 1938, but that a claim for certain additional taxes relative to the year 1937 was not barred by the statute of limitations because the Gin Company had omitted from gross income an amount which the court held was properly includable therein in excess of 25 percent of the amount of gross income stated in its return.

For other cases on the right to exclude or deduct patronage refunds made in pursuance of a mandatory obligation to make them in computing income taxes, see United Cooperatives, Inc. v. Commissioner, 4 T.C. 93, and American Box Shook Export Association v. Commissioner, 156 F.2d 629. See also Farmers Union Co-operative Co. v. Commissioner, 90 F.2d 408.

Processing Taxes -- Cooperative a Trustee

In California & Hawaiian Sugar Refining Corporation, Ltd. v. Commissioner, 163 F.2d 531, it appeared that the sugar refining corporation was a California cooperative marketing association organized under the California Agricultural Code. The members of the cooperative were 30 producers of raw sugar in the Hawaiian Islands who transferred title to their sugar under a marketing contract to the cooperative for processing and sale. Under the marketing contract the amount the cooperative was to return to its members was to be determined by the prices received by the cooperative for the sugar. In brief, the contract provided that the cooperative was to account to its members for the amount received for the sugar less operating and maintenance costs and expenses and any other authorized deductions.

The cooperative instituted proceedings before The Tax Court of the United States for the purpose of obtaining a refund "of processing taxes, imposed by the Agricultural Adjustment Act of 1933, 7 U.S.C.A. § 601 et seq., and held invalid in United States v. Butler, 297 U.S. 1, 56 S.Ct. 312, 80 L.Ed. 477, 102 A.L.R. 914. One sought refund of taxes upon the processing of raw sugar transferred to it by the contract and the other a refund of such taxes on processing jute bought from other persons and made into bags to contain the refined sugar."

The Tax Court dismissed the petitions on the ground that the cooperative, in accounting to its members, deducted the processing taxes which it had paid, and hence that the cooperative did not bear such processing taxes. Under the law no processing taxes may be recovered by a processor if he has not borne the tax. In other words, if the processor required the person from whom commodities were acquired to bear the tax, or if the processing taxes were passed on to the person to whom the processor sold the commodities the processor would not be entitled to recover processing taxes that he had paid. As stated, the Tax Court proceeded on the theory that the cooperative had not borne the processing taxes because it had deducted them in accounting to its members.

In reversing the decision of the Tax Court, the Circuit Court of Appeals for the Ninth Circuit said in part:

> "There is no question that the moneys sought to be recovered were illegally taken by the government and in good faith should not be retained by it. Congress in discharging the moral obligation to refund the illegal collection permitted suits against the sovereign by the processor who paid it if the processor is one who in legal contemplation bore the burden of the tax. If, however, the processor has not had the burden of the tax or has transferred it to another person or persons, the right to sue the sovereign is given to the persons upon whom the burden was actually inflicted. * * *
>
> * * * * * * *
>
> "The Tax Court held that by the terms of the contract of sale from its members to the cooperative, set forth in the claim to the Commissioner and in the petition, both the sugar and jute processing taxes were not inflicted upon the cooperative but the burden assumed by the selling members by an agreed reduction in the amount of such taxes from the price of the raw sugar paid them by the cooperative.
>
> "The Tax Court's opinion shows no consideration of the law of California for its marketing cooperatives, under which several relationships may be created between the cooperative and its members as to the capacity in which it may hold and deal with the raw sugar to which title is transferred by the member owners. Under that law may be created such relationship as is desired.

"It is obvious that such holding and disposition may be in one of at least three capacities: (a) As an ordinary purchaser by an ordinary sale; (b) as agent holding the title and processing and selling as such agent for its principals the member transferors; and (c) as trustee of the raw sugar, the corpus of the trust, the proceeds of which, after refinement and sale, it holds in trust for the transferring members as beneficiaries.

"On these questions of California law the briefs of both parties agree that the instant relationship between the members and the cooperative is not that of principals and agent. The cooperative it is there agreed is not a mere agent processing a 'customer's' raw sugar for a fee under Sec. 913(a) of the Act of June 22, 1936, 7 U.S.C. 655, 7 U.S.C.A. § 655.

"The cooperative claims that the Tax Court erred in its holding that the instant contract of sale was an ordinary contract in which the seller members assumed the taxes in the deduction of their amounts from the sales price paid them. * * *

* * * * * * *

"In the case of Bogardus v. Santa Ana Walnut Growers Ass'n, 41 Cal. App.2d 939, 108 P.2d 52, the members of that California cooperative, under a continuing marketing contract, sold it their walnuts to be processed and 'resold' as in the instant case. The Santa Ana association was a local branch of a central association to which the local in turn sold the processed walnuts for resale to the trade. The local was about to distribute the proceeds it received from the central association to its members supplying the walnuts when a suit was brought to enjoin such distribution. The plaintiff claimed the right to enjoin on the ground contended by the Commissioner here, that the sale of the walnuts was an ordinary sale and hence that the local cooperative was entitled to keep the proceeds as its corporate property.

"The California district court of appeal affirmed a dismissal of the injunction suit. It decided that the contract made the local a trustee for the members transferring the walnuts to it. * * *

* * * * * * *

"It thus appears that under the California law the relationship created by the contract in the 'passage of title, and the terms of purchase and sale,'--that is from the very beginning--is that of a trust, with the members as settlors creating a trust estate for themselves as beneficiaries.

"The continuing walnut contract in the Bogardus case, like the raw sugar contract here, provided for the deduction of the costs and expenses of processing and sale, as here was deducted the expense

of the processing taxes. We are unable to distinguish the two cases. By the so-called contract of sale this sugar cooperative is made a trustee by the members as settlors. The provision for the deduction of expenses in the trust instrument is not the 'reduction of the price paid for any such commodity' as provided in Section 902, supra, but an expense of the trust administration.

"By such manner the settlors create the status of the trustee just as the stockholders in articles of incorporation create the corporate entity, or as the partners in their agreement create the partnership entity. Like the agreement here, the stockholders' subscription agreement is frequently for successive installments. It can no more be said that the trustee transfers the burden of his tax in the reduced amount distributed to his beneficiaries, than does the corporation in a distribution of net earnings after deducting such tax transfer its burden to the stockholders who created it.

* * * * * * *

"Such being the relationship, the Tax Court erred in holding that the cooperative was relieved of the burden of the processing tax by virtue of its contract with its members. The solution here determined we think is in accord with the Congressional intent. It provides no unjust enrichment to the cooperative which must return to its members the recovered amount of the illegal tax, if it has not otherwise transferred its burden. * * *" (Emphasis added.)

As shown by the foregoing quotations from the opinion of the circuit court of appeals that court held that the cooperative was entitled to treat the processing taxes as an expense the same as any other outlays incurred in the processing and marketing of the sugar. Obviously, the relation between a cooperative association functioning under a marketing contract like that involved in the instant case is quite unlike that which exists in a case in which a purchaser acquires title to commodities for a fixed price with no obligation to account to the producer for any amounts that he may obtain for the commodities on their resale. The fact that title passes to a cooperative association under a marketing contract is simply for purposes of convenience and to facilitate the marketing of the commodities for the benefit of the members of the cooperative. Under these conditions a cooperative is functioning in a trustee capacity, and is really the alter ego of its members.

Liquidated Damages Denied

The case of Olson v. Cooperative Raisin Growers Association, (Cal. App.), 184 P.2d 742, is a novel one involving the law of liquidated damages in California. As three of the members of the board of directors of the cooperative had delivered wet raisins, the association was apparently unwilling to bring a suit against those members who had delivered wet raisins to the association. Certain of the members of the association,

therefore, filed a suit against the members of the association in question and against the association for the recovery of liquidated damages.

Judgment was recovered in the trial court for liquidated damages in the amount of $19,846.79, besides interest and costs, against the defendants, and they appealed. On appeal, the decision of the trial court was reversed because the appellate court was of the opinion that neither under the law of California nor under the marketing contract of the cooperative, which provided for liquidated damages, were the defendants liable for such damages because of the delivery of raisins by them to the association that were substandard in quality.

About twenty growers of raisin grapes formed the cooperative association under the laws of California. The association entered into a contract with a certain person under which he was to receive and pack raisins on their delivery by members of the association. The marketing agreement entered into by the cooperative with each of its members contained a provision reading as follows:

> "In the event that Grower should fail to deliver raisins hereby sold in accordance with the terms of this agreement and these By-Laws, such act will injure the Association to an amount that is, and will be impracticable and extremely difficult to determine and fix, and that is, therefore, fixed at the amount of Twenty-five (25%) per cent of the average current seasonal price for each and every ton of raisins that the Grower fails to deliver in accordance with the terms hereof and these By-Laws, and which amount the Grower agrees to pay, and shall pay, to the Association upon demand, * * *."

It was admitted that all of the defendants had delivered the raisins grown by them. It appeared, however, that a part of the raisins delivered by them contained a higher moisture content than was normal and that such raisins could not be processed on their delivery because of this fact.

The cooperative act of California under which the association was incorporated contains a provision reading as follows:

> "The by-laws or the marketing contract may fix, as liquidated damages, specific sums to be paid by the member or stockholder to the association upon the breach by him of any provision of the marketing contract regarding the sale or delivery or withholding of products; * * * and such clauses providing for liquidated damages shall be enforceable as such and shall not be regarded as penalties." (Underscoring added.)

The Code of California specifically provides that liquidated damages may be stipulated only in cases in which it would be "impracticable or extremely difficult to fix the actual damage," and so unless the provisions for liquidated damages contained in the marketing contract of the association covering the delivery of raisins that were substandard

in quality were authorized by the statute under which the cooperative association was organized, the association was not entitled to recover liquidated damages. Attention is called to the fact that the statute under which the association was incorporated authorized providing for liquidated damages in only three instances; namely, upon a breach of a contract with respect to sale, or delivery, or the withholding of products that might be covered by a contract.

In holding that the association was not entitled to recover liquidated damages the court held that (1) the law did not authorize liquidated damages because of the delivery of substandard raisins, and (2) the marketing contract did not in itself provide for the payment of liquidated damages in instances in which the substandard raisins in question had been delivered. In this connection the court said in part:

> "It is firmly established in California as a general rule that a contract may not fix the amount of damages to be paid for a future breach except in a case where it would be impracticable or extremely difficult to determine the actual damages sustained. It is also generally held that the impracticability or difficulty in determining the actual damages suffered must be alleged and proved by the party seeking to recover liquidated damages. Rice v. Schmid, 18 Cal.2d 382, 115 P.2d 498, 138 A.L.R. 589; Robert Marsh & Co. Inc., v. Tremper, 210 Cal. 572, 292 P. 950; Dyer Bros. Golden West Iron Works v. Central Iron Works, 182 Cal. 588, 189 P. 445; Kekich v. Blum, 43 Cal. App.2d 525, 111 P.2d 411.
>
> "An important exception to this general rule had been established in the case of non-profit cooperative marketing associations by the sections of the Agricultural Code from which we have already quoted. This exception permits such associations and their members to fix by contract the liquidated damages to be paid upon a breach of the contract in the particulars of the sale, or delivery, or the withholding of products that may be the subject of contract. While these provisions contain a grant of power that power is limited to the three subjects particularly and clearly mentioned so any attempt on the part of the association to go beyond those express powers granted must fall within the provisions of sections 1670 and 1671 of the Civil Code which only permit the recovery of liquidated damages where it would be impracticable or extremely difficult to fix the actual damages and the further rule established by the cases already cited that the impracticability or extreme difficulty in fixing the actual damages must be alleged and proved.
>
> "It is well established by a long line of decisions even prior to the adoption of the Agricultural Code that a non-profit cooperative marketing association could contract for the payment by a member of a fixed sum for the violation of his agreement to deliver all of his products to the association for processing and marketing. Anaheim Citrus Fruit Ass'n v. Yeoman, 51 Cal.App. 759, 197 P. 959;

California Canning Peach Growers v. Downey, 76 Cal.App. 1, 243 P. 679; California Canning Peach Growers v. Harris, 91 Cal.App. 654, 267 P. 572; Irwindale Citrus Ass'n v. Semler, 60 Cal.App.2d 318, 140 P.2d 716. All such cases deal with the quantity of fruit not delivered by a member who refused to deliver all his products to the marketing association. The quality of the fruit delivered was not an issue and was not considered in any of the cases. In the case the quantity of the raisins delivered is not an issue as it is admitted that the members delivered all of their raisins to Biola. It is the quality of the raisins that is in issue here so the decided cases are of no great assistance to us. It remains to be considered in the first instance whether or not the growers who delivered wet raisins violated their marketing contract in any of the particulars mentioned in section 1209 of the Agricultural Code in regard to 'the sale or delivery or withholding' of products.

"Section 1 of the marketing agreement contemplates a sale of the raisins by the grower to Biola when it says that 'the Association buys and the Grower sells to the Association * * *' his crop of raisins. Thus they contracted for a sale of the raisins for future delivery. This brings into force the provision of section 1208 of the Agricultural Code that 'if they contract a sale to the association, it shall be conclusively held that title to the products passes absolutely and unreservedly, except for recorded liens, to the association upon delivery.' Thus a sale of the raisins occurred and was completed on delivery and acceptance by Biola and the packer and no question remains of a breach by a grower of his obligation to sell his raisins to Biola. It is equally clear that there was no breach of his obligation by any grower in failing to deliver or by withholding any or all of his raisins, it being admitted that each grower delivered all his raisins to Biola. It follows that there was proved no breach of any of the three conditions set up in the Agricultural Code under which liquidated damages might be contracted for and recovered.

* * * * * * *

"Next a study of the entire marketing agreement leads to the opinion that it was the intention of its framers to permit the recovery of liquidated damages only when a grower failed or refused to deliver all his raisins to Biola. Section 13 seems to be a summary of the prior provision on this subject. It conditions the agreement to pay liquidated damages upon the fact of failure to deliver. Section 7, the liquidated damage section, also suggests that it was intended to cover failure to deliver and not failure in the quality of the product. In addition to other provisions the section states that it would be impracticable and extremely difficult to fix the damages for failure to deliver raisins in accordance with the terms of the marketing agreement. It has been held that this is a true statement of a fact in the case of the failure to deliver. It is not true in case of the

delivery of inferior quality raisins for the reason that raisins are graded and each grade has an ascertainable market value which may vary from season to season and from time to time. Raisins not properly cured have a less market value than those properly cured. The loss from a violation of this provision of the contract as to quality may be ascertained and determined under the ordinary rules of the law of damages.

"This conclusion as to the damages in this case being ascertainable is supported by plaintiffs themselves. In their amended complaint they allege the loss from the delivery of wet raisins 'to be upwards of $20.00 per ton'. In their brief they arrive at the conclusion that 'there was a net loss of $21.87 on each ton of raisins not packed out and delivered to the government.' They reach this conclusion by the use of various government regulations effective in 1944 of which they urge us to take judicial notice.

* * * * * * *

". . . . As the actual damages to Biola from the delivery and acceptance of wet raisins were easily ascertainable and are not impracticable or extremely difficult to fix, the recovery of liquidated damages cannot be approved."

It will be remembered that at common law if the amount stipulated by the parties as liquidated damages was exhorbitant or unreasonable, that the courts would refuse to enforce such a provision on the ground that it was a penalty. Bignall v. Gould, 119 U.S. 495, 7 S.Ct. 294, 30 L.Ed. 491. In nearly all of the cooperative acts, associations are authorized to provide for the payment of liquidated damages. It is believed that even under these statutes the amounts stipulated to be recovered by an association on account of a breach of a marketing contract by a member must be reasonable. In drafting the provisions for liquidated damages, care should be taken to insure that the rule prescribed will be fair, equitable and clear under all circumstances.

In a Washington case a provision for liquidated damages providing for the payment of $10 per cow in the event a member marketed any milk outside the association, was criticized on the ground that it was uncertain whether the $10 per cow was to be determined on a per day basis, or once and for all, or whether it would be applicable if a member marketed outside the association the milk from some cows but not from all. Pierce County Dairymen's Ass'n v. Templin, 124 Wash. 567, 215 P. 352; see also Dairymen's League Co-op. Ass'n. v. Holmes, 202 N.Y.S. 663. And of course when a cooperative association is entering into contracts with third persons the general and fundamental rules with respect to liquidated damages are as applicable to cooperative associations as they are to anyone else. In this regard see Watertown Milk Producers' Cooperative Association v. Van Camp Packing Company, 199 Wis. 379, 225 N.W. 209, 226 N.W. 378, 77 A.L.R. 391, and Dairy Co-operative Association v. Brandes Creamery, 147 Ore. 488, 30 P.2d 338, 147 Ore. 503, 30 P.2d 344.

In connection with the case discussed above, see the companion case of Biola Cooperative Raisin Growers Ass'n. v. Scheidt, (Cal. App.), 164 P.2d 747.

Investigating Eligibility for Exemption

The case of United States v. Stiles, 56 F.Supp. 881, was a proceeding against W. G. Stiles as president of the Arkansas Burial Society, Inc., to require him to appear before an agent of the Bureau of Internal Revenue to testify and produce before that agent "certain books and papers of the Society." It appeared that an agent of the Bureau of Internal Revenue issued an administrative subpoena which was served upon Stiles commanding him to appear before the agent at Fort Smith, Arkansas, at a given time and date "to give testimony concerning the tax liability of said society and further commanding him to produce certain books and papers of the Society." It appeared that:

> "... upon the service of the subpoena the respondent, Stiles, advised the agent of the revenue service that he had no intention of obeying any such administrative subpoena and that he had no intention whatsoever of permitting the agent or any other agent or employee of the Internal Revenue Service of the petitioner to inspect or examine the books and papers of the Society."

Section 3614(a) of 26 U.S.C. reads as follows:

> "The Commissioner, for the purpose of ascertaining the correctness of any return or for the purpose of making a return where none has been made, is authorized, by any officer or employee of the Bureau of Internal Revenue, including the field service, designated by him for that purpose, to examine any books, papers, records, or memoranda bearing upon the attendance of the person rendering the return or of any officer or employee of such person, or the attendance of any other person having knowledge in the premises, and may take his testimony with reference to the matter required by law to be included in such return, with power to administer oaths to such person or persons."

In view of the refusal of Stiles to appear before the agent of the Bureau of Internal Revenue in keeping with the foregoing code provision, proceedings were instituted against Stiles and the Society in pursuance of Section 3633(a) of 26 U.S.C., which reads as follows:

> "If any person is summoned under the internal revenue laws to appear, to testify, or to produce books, papers, or other data, the district court of the United States for the district in which such person resides shall have jurisdiction by appropriate process to compel such attendance, testimony, or production of books, papers, or other data."

The following quotations from the opinion show the issues raised and the conclusion of the court:

"On September 6, 1944, the respondents filed an amended response and answer to the original petition in which they admitted that the respondent, Arkansas Burial Society, Inc., is a benevolent association or corporation organized under the laws of Arkansas, with its principal place of business at Fort Smith, Arkansas, 'admit that said association has been engaged in business for the years 1934-43, both inclusive, and that it has paid no income tax to the United States and filed no tax return for any of said years.'

"They admitted Arthur L. McNew, as agent of the Internal Revenue Service of the United States on June 27, 1944, issued a subpoena directed to respondent, Stiles, commanding him to appear at the time and place alleged by petitioner to give testimony concerning the tax liability of the respondent, Society, and produce certain books and papers of said society as alleged in the petition; that the said respondent, Stiles, refused to obey said subpoena 'for the reason that said society is exempt from taxation, and the action of the said McNew was wholly unnecessary and unauthorized, and that said respondents were not required to submit to such examination.'

"The respondents further alleged that the Arkansas Burial Society, Inc., is a local benevolent corporation organized under Section 2252 et seq., Pope's Digest of the Statutes of Arkansas, providing for the incorporation of benevolent associations; that since its organization the society has continuously engaged and is now engaged in business as such benevolent association; that it has no capital stock and operates solely and exclusively as a non-profit association for the mutual benefit and protection of its members; that its purpose and design is to accumulate a fund from the contributions of its members, for beneficial and protective purposes, which said fund is used for their aid and relief in the event of death of such members or their families and to provide for them a decent burial and the observance of necessary funeral obsequies; that the amount of dues paid by the individual members is determined by scientific actuarial study in order that the lowest feasible rate for members may be charged which at the same time will maintain said society as a solvent association without profit; that the respondent is under the supervision of the State Banking Department of the State of Arkansas, which has promulgated certain rules and regulations governing the expenditure by the society of the dues so collected, and requiring the society to retain 5 per centum of all dues paid by members each year for the purpose of establishing a reserve fund for use in paying losses occurring from an increased death rate caused by plagues, epidemics or other disasters; that the said fund is not income subject to taxation, but is a necessary allocation of its funds to secure its solvency and the prompt payment of its obligations to all members; that 75 per centum of the dues of said society is used for the purpose of establishing a mortuary fund available at all times for the payment of losses and liabilities of the society, which fund is used for that purpose, but is not always sufficient to pay the losses sustained by said

society and when the mortuary fund is exhausted, recourse is then had to the reserve fund to the end that all losses are paid promptly; that the society is of like character to benevolent life insurance associations of a purely local character and that 85 per centum or more of its income consists of amounts collected from members for the sole purpose of meeting losses and expenses; that the society is exempt from taxation under Section 101(10) of the Internal Revenue Code, 26 U.S.C.A. Int.Rev.Code, § 101(10).

"The respondents further alleged:

"'That it is not necessary for said society to make or file income tax returns for the reason that it is exempt from taxation, and that the proposed examination and production and examination of its books, records and other papers is wholly unnecessary and is not warranted or justified by law.'

"On September 7, 1944, the petitioner filed its motion to strike the amended response and answer.

"The motion to strike raises the legal sufficiency of the amended answer and response, and in determining the question the court is required to accept as true for the purposes of the motion the allegations of material facts set forth in the answer and response.

"The respondents contend that under the facts as alleged that the respondent, Society, is exempt from taxation by virtue of the provisions of Section 191(10) of the Internal Revenue Code, 26 U.S.C.A. Int.Rev.Code, § 101(10). That section in so far as material here reads:

"'The following organizations shall be exempt from taxation under this chapter-- * * *

"'(10) Benevolent life insurance associations of a purely local character, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations; but only if 85 per centum or more of the income consists of amounts collected from members for the sole purpose of meeting losses and expenses.'

"The petitioner contends that the inspection of the books and papers of the society and examination of respondent, Stiles, are preliminary inquiries which the Commissioner of Internal Revenue has a right to make as necessary prerequisities to his making an assessment of income taxes for the years involved herein, and that the commissioner has a right to make the investigation irrespective of the ultimate liability of the respondent, Society, to income taxation.

"The respondents on their written brief do not specifically contend that the court has jurisdiction in this proceeding to adjudicate the tax liability of the respondent society, but contend that since the society is exempted from the income tax liability that the proposed investigation and examination are unnecessary and burdensome. In effect, the respondents contend that the respondent, Society, is not a taxpayer under the law, and that it did not make a return because it is not liable for income tax, and since it is not liable for income tax the investigation and examination of its books are unnecessary and not authorized by law. They admit that taxpayers are required to make returns and that under the statute, 26 U.S.C.A. Int.Rev.Code, § 3614, the Commissioner of Internal Revenue is authorized to examine books, papers and witnesses for the purpose of ascertaining the correctness of the return of the taxpayer or for the purpose of making a return for such taxpayer when none has been made, but that the statute, Section 3614, supra, is not applicable because the respondent, Society, is exempt.

"The mere fact that the respondents allege that the Society is exempt from taxation; that it is not a taxpayer and not required to make and file a return does not in law make it exempt. In the construction of a statute laying a tax, doubts should be resolved most strongly against the government, but in the construction of a statute granting exemptions a strict construction in favor of the government should be made. The taxing power is of vital importance to the very existence of the government and exemptions should never be presumed or allowed unless they are provided by clear and unambiguous terms of the statute. Yazoo & Mississippi Valley Railroad Co. v. Thomas, 132 U.S. 174, 10 S.Ct. 68, 33 L.Ed. 302.

"No tax has been assessed against the Society. It may be that it is not liable for any tax and the proposed investigation might reveal facts which would make a return unnecessary, but that question cannot be determined by the Society. The Commissioner of Internal Revenues has a right to make a return and assess a tax on such return. 26 U.S.C.A. Int.Rev.Code, § 3612. And no suit for the purpose of restraining the assessment or collection of the tax can be maintained. 26 U.S.C.A. Int.Rev.Code, § 3653. The Declaratory Judgment Act does not apply to questions involving federal taxes. 28 U.S.C.A. § 400.

* * * * * * *

"If the society is in law exempt from taxation, no return is required and the examination of its officers and books and records would be unnecessary, but the court does not believe it would be oppressive or unreasonable to require the society to submit to such examination since it is evident that the Internal Revenue Service thinks the society is liable for taxes. The Internal Revenue Service is charged with the duty of collecting taxes

from those liable therefor and how can it determine the liability of an organization other than by examination in the manner provided by law? If the right to make such examination is denied on the mere claims that the society is exempt from taxation, the court would in effect open the door to similar claims from every person or organization and would be taking from the Commissioner of Internal Revenue the duty of ascertaining whether a tax is due in his opinion. If the examination is made, followed by an assessment of a tax, the society may pay the assessment and then in a suit to recover the payment the court will determine the question of liability." (Underscoring added.)

The opinion does not show whether the Arkansas Burial Society had ever received a so-called letter of exemption from the Bureau of Internal Revenue. Even if such a letter had been received, it would not, of course, have prevented the Bureau from making an investigation for the purpose of determining if the Society were eligible for exemption, and if not, the amount of taxes, if any, that it might be required to pay.

It will be remembered that a letter of exemption is not binding upon the Bureau of Internal Revenue if later that Bureau ascertains facts which show that there was no basis for the holding that the organization in question was or has become ineligible for exemption. The fact that the Bureau may have erroneously held an organization eligible for exemption is not binding on Commissioners of Internal Revenue, who may set the so-called exemption aside. See in this connection Southern Maryland Agricultural Fair Association v. Commissioner of Internal Revenue, 40 B.T.A. 549. And of course an organization may have been eligible for exemption at the time the Bureau held it was an exempt organization, but later, due to changes in its organization papers or in its operating methods it may have become ineligible for exemption. In any event it is clear that the Bureau of Internal Revenue has ample authority to make investigations for the purpose of ascertaining the income tax status of any organization.

Trademark Invalid, But Imitator Guilty of Unfair Competition

The case of Fruit Growers Co-op v. M. W. Miller & Co., 73 F.Supp. 90, was an action for infringement of the trademark, "Sturgeon Bay," registered under the Act of March 19, 1920, 15 U.S.C.A. 121 et seq., and for unfair competition.

The court held that the geographical term "Sturgeon Bay" was not a valid trademark so as to entitle the cooperative to prevent others from using the geographical name, and quoted the following with approval from a decision of the Supreme Court of the United States:

"that no one can apply the name of a district or country to a well-known article of commerce, and obtain thereby such an exclusive right to the application as to prevent others inhabiting the district

or dealing in similar articles coming from the district from truthfully using the same designation."

The court further held that the registration of the trademark gave jurisdiction to the court of the action "regardless of diversity of citizenship or amount in controversy, both as to infringement and unfair competition. Armstrong Paint & Varnish Works v. Nu-Enamel Corp., 305 U.S. 315, 59 S.Ct. 191, 83 L.Ed. 195."

Although the geographical term "Sturgeon Bay" was not the subject of a valid trademark, the court held that the imitation of the labels of the cooperative by the defendant constituted unfair competion. In this connection the court said in part:

"The defendant was a latecomer into the field of selling canned and processed cherries. He well knew that the plaintiff had used the name 'Sturgeon Bay Brand' as a designation of its cherries, and yet when defendant designed the cover of his 30-pound tin, Exhibit 3, he had the words 'Sturgeon Bay' in large letters placed immediately over a cluster of six red cherries. The shape, the size and the location of the cherries are identical with the design on plaintiff's 30-pound-can cover, Exhibit 17, except that defendant omitted two green leaves from his design. However, on the labels which were attached to two smaller sizes of cans (Exhibits 1 and 2) the defendant did not bother to omit the green leaves, so that the cluster of cherries appearing immediately under the name 'Sturgeon Bay,' appearing in large letters, would give one making a casual inspection the impression that they were labels used by the plaintiff on its quality products.

"It was accident no coincidence that the cluster of cherries on defendant's labels and on his can covers were the same size and shape as on plaintiff's design and located immediately under the name 'Sturgeon Bay' which appeared in large letters. It was a deliberate effort on defendant's part to receive the benefit of the good will which the plaintiff and its predecessors had built up during many years of business activity.

"The defendants should not be enjoined from using the words 'Sturgeon Bay' on their labels to designate their business location, and in view of the long use by Reynolds and others of the term 'Sturgeon Bay Cherries' they should not be denied the privilege of using that term, but, if used, it must be in a subordinate position. A number of the labels of the Reynolds Preserving Company use the name 'Sturgeon Bay Cherries,' but no one of the public would be deceived in view of the comparatively small type in which those names appear.

"A judgment for the plaintiff may be entered restraining all the defendants from the use of the name 'Sturgeon Bay' in large letters upon their labels or can covers, and also from using the picture of

the cluster of cherries such as has been used by the plaintiff. The judgment may provide that the letters of the words 'Sturgeon Bay' appearing on any of defendants' labels shall not be more than one-third in size to the words 'All Star' or other designation of a brand name of the defendants." (Emphasis added.)

In any instance in which a seller is palming off his goods as the goods of another, he is guilty of unfair competition, and regardless of whether the trademark of the injured person is valid or invalid, ordinarily such injured person is entitled to equitable relief. In this regard the court said:

"It has been held that unfair competition is distinguishable from infringement of a trade-mark in this: that it does not involve necessarily the question of exclusive right of another to the use of the name, symbol or device. A word may be purely generic or descriptive, and therefore not capable of becoming an arbitrary trade-mark, and yet there may be an unfair use of such word or symbol which will constitute unfair competition. G. W. Cole Co. v. American Cement & Oil Co., 7 Cir., 130 F. 703, 705." (Emphasis added to last sentence.)

No Labor Dispute -- Injunction Granted

In the case of Denver Milk Producers v. International Brotherhood of Teamsters, Chauffeurs, Warehousemen and Helpers' Union et al., decided by the Supreme Court of Colorado, 183 P.2d 529, it was held that an injunction was in order. The basis for the ruling is summarized in two headnotes, to the opinion, reading as follows:

"Where unions threatened to destroy plaintiffs' businesses unless they should sign union contracts, displayed force against truck drivers of nonunion carriers preventing nonunion carriers from delivering milk to union dairies, caused union brick layers engaged in necessary construction work in dairy to cease work, and threatened to picket retail stores unless they ceased to sell milk of nonunion dairy, there was no 'labor dispute' within Labor Peace Act prohibiting injunctions in labor disputes and hence plaintiffs were entitled to permanent injunction restraining such acts. Laws 1943, c, 131, §§ 2(7), 16."

"The issuance of permanent injunctions restraining unions and their members from engaging in secondary boycott, picketing, etc., could not be refused on theory that they would be deprived of their rights under the First, Thirteenth and Fourteenth Amendments to the Federal Constitution. Laws 1943, c, 131, §§ 2(7), 16; U.S.C.A. Const. Amends. 1, 13, 14."